IN THE

Supreme Court of the United States

October Term, 1942.

No. 184.

HENRY A. KIESELBACH AND OLGA M. KIESELBACH,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

BRIEF FOR THE PETITIONERS.

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STATUTES:

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OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals (R. 33-37) is reported at 44 B. T. A. 279. The opinion of the Circuit Court of Appeals for Third Circuit (R. 42-50) is reported at 127 F. (2d) 359.

JURISDICTION.

The judgment of the circuit court of appeals was entered April 7, 1942. (R. 42) Petition for a writ of certiorari was filed June 27, 1942, and was granted October 12, 1942, limited to the first question presented by the petition for certiorari. (R. 52) The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code, as amended, by the Act of February 13, 1925.

QUESTION PRESENTED.

Whether the part of the award of just compensation computed by the use of an interest factor is a part of the selling price of the property and taxable as capital gain or is a separate and distinct item of income, taxable as ordinary income.

STATUTES INVOLVED.

The statutes involved will be found in the Appendix, *infra*, pp. 28-31.

STATEMENT.

The petitioner, Henry A. Kieselbach, inherited a parcel of property from his father on April 2, 1927. The City of New York, for the purpose of opening and extending certain streets, filed a proceeding in court late in 1930, asking for authority, *inter alia*, to condemn the building and improvements and a certain portion of the land owned by the petitioner. The court on that same day entered an order granting the application and providing that the compensation should be determined by the court. (R. 29) The petitioner on July 2, 1931, filed his formal claim for just compensation. (R. 29) On December 16, 1932, the Board of Estimate passed a resolution purporting to vest the title in fee to the real property in the City as of January 3, 1933. (R. 29) The City took possession on that date. (R. 34) The condemnation proceeding was tried between March 25, 1933 and February 19, 1935. The court entered its tentative decree on February 17, 1936, fixing tentative awards

and assessments. The petitioner on March 10, 1936, filed objections to the tentative decree. Hearings were held on the objections during March and April of 1936. The amount of the assessment against the petitioner was reduced upon consideration of his objections. The court entered a final decree on March 31, 1937, providing that the amount awarded to the owners of the properties including petitioner was the just compensation to which the respective owners were entitled to receive from the City. The amount awarded to the petitioner was $73,246.57, which was paid on May 12, 1937. The total award was computed by adding to a principal amount of $58,000 "interest" as provided by Sec. 976 of the Greater New York Charter, at 6 per cent from January 3, 1933, amounting to $15,246.57. (R. 30-31) The basis to the petitioner was $41,866.25, the attorney's fees and assessments were $3,304.31 and the net gain on the sale of the property was $28,076.01. (R. 22)

The petitioners in their joint original return for the year 1937 reported the net gain or profit on the sale of the property as capital gain, limiting the taxable portion to 30 per cent under Sec. 117(a) of the Revenue Act of 1936. The Commissioner of Internal Revenue on May 5, 1939 proposed a deficiency against the petitioners in the amount of $2,826.90, based upon the separation of the gain into two parts and the taxing of $15,246.57 thereof as ordinary income (R. 38), and the inclusion in income of 40 per cent of the balance of the capital gain instead of 30 per cent as reported in the return. The petitioners appealed from this determination to the United States Board of Tax Appeals. (R. 3) The Commissioner in an amended answer asserted an additional deficiency in the amount of $2,089.67 upon the ground that the condemnation was not a sale of the property within the meaning of Sec. 117 (a) and that the entire gain was ordinary gain and not capital gain. (R. 44)

The Board of Tax Appeals held (1) that the taking of the property by condemnation was a sale within the meaning of Sec. 117 (a) and the profit from the sale taxable as

capital gain, (2) that the entire amount received as just compensation for property was the amount realized from the disposition of the property even though the computation by which it was determined included so-called "interest," and (3) that 30 per cent of the capital gain should be included in income as the petitioner held the property for a period of more than 10 years, complete title, under the laws of New York, not passing until May 12, 1937. (R. 61)

The Commissioner filed a petition for review to the Circuit Court of Appeals for the Third Circuit and that court affirmed the Board on the first question, namely, that a transfer of property through condemnation proceedings is a "sale" within the meaning of Sec. 117 (a). It reversed the Board on the other two questions, holding (1) that the so-called "interest" used in computing the just compensation was taxable as ordinary gain and (2) that the petitioners held the property for less than ten years.[1]

The petition for a writ of certiorari was filed on the latter two questions. It was granted on October 12, 1942, limited to the first question.

SUMMARY OF ARGUMENT.

The entire amount received by the petitioners from the City of New York was compensation for their property. The petitioners completed a single transaction in which a single net capital gain was realized. The net gain on the condemnation of property is admittedly taxable as capital gain. The decision of the circuit court of appeals separates the net gain into two parts, taxing part as capital gain, after allowing expenses and assessment against that part, and part as ordinary income with no allowance for expenses against the ordinary income. There is no basis in law for the separate taxation of a single gain on two different bases.

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[1] The case was argued before Circuit Judges Clark, Jones, and Goodrich (R. 42). Judge Clark did not participate in the decision (R. 50).

The so-called "interest" included in the award is an integral part of the just compensation. It is not a separate item of taxable interest. It is paid to the property owner not as a penalty, or as a statutory award, but as part of the lawful and necessary full compensation for the property taken.

The usual import of the term interest within the revenue laws is the amount which one has contracted to pay for the use of borrowed money. It does not include payment made as a part of the purchase or sales price of property. In condemnation proceedings, so-called "interest" is merely an element used in the determination of the just compensation.

The courts and the Commissioner have refused to segregate so-called "interest" included in either the sales or purchase price of property for income tax purposes. This has been the long established administrative rule. This Court in analogous cases has refused to segregate deductible taxes and expenses included in the purchase price of property. The present administrative rule, GCM 20322 (CB 1938-2 p. 167), supported by excellent authorities, is that *the various steps incident to a condemnation project, "including the condemnation award for the property taken, the award for severance damages to and a special benefit assessment levied against the remaining portion of the plot or parcel of real estate affected, constitute a single proceeding, the results of which are to be calculated as an entirety for Federal income tax purposes."*

The decisions of the Second Circuit in *Seaside Improvement Co.* v. *Commissioner*, 105 F. (2d) 990, certiorari denied on other issues, 308 U. S. 618, and *Commissioner* v. *Appelby's Estate*, 123 F. (2d) 700, with which the decision below is in direct conflict, are in agreement with precedent and sound in principle. The Second Circuit correctly applied the doctrine of the decisions of this court as to the nature of "interest" allowed as a part of damages in a condemnation award, and decisions of other circuits refusing

to tax such "interest" as a separate and distinct item of income, apart from the award itself. The Board of Tax Appeals is presently following the Second Circuit.

The circuit court of appeals failed to follow the settled rule of this court that the compensation in eminent domain cases includes "interest," not as interest per se, but as a part of the damages awarded for the taking of the property. It is in conflict with decisions of other circuit courts of appeal which have refused to tax the so-called "interest" on a different basis than the award itself. The principle of the decision below will result in taxation of part of the proceeds as ordinary income even in cases in which in reality a loss is sustained. It will result in difficulty of administration of the statute, and is contrary to the present administrative rule which treats the various steps incident to a condemnation proceeding as a single taxable event.

It is respectfully submitted that the decision of the Circuit Court of Appeals for the Third Circuit should be reversed and the decision of the Board of Tax Appeals be affirmed.

ARGUMENT.

I.

The Entire Amount Received by Petitioners from the City of New York Was Compensation for Their Property.

The statute under which the condemnation proceedings took place permits the city to acquire "such interest in real property as will promote public utility" (Sec. 970, R. 9). The compensation to owners of real property to be acquired * * * shall be ascertained by the Supreme Court and the City must apply to the Court "to have compensation which should be justly made to the respective property owners of the real property proposed to be acquired, ascertained and determined by said Court * * *." There are provisions permitting the City to take possession upon adoption of a resolution by the Board of Estimate prior to the final decree, as was done in this case. The legislature was not

unmindful of the constitutional requirements that the compensation must be the fair and full equivalent of the property taken, so it was provided that an additional sum computed by the use of interest at legal rates should be added *"as part of the compensation to which such owners are entitled."*

The property owners would have been entitled to this additional sum without the provisions of Section 976. They had a constitutional right to it as a part of the award.

The order granting the City's petition of condemnation provided "that the compensation which should justly be made to the respective owners of the property proposed to be taken, be ascertained by the Court * * *." (R. 57) The proceedings which followed were to determine "the compensation which should justly be made to the owners of the property * * *" including petitioner. The petitioner's formal claim was for "just compensation in the pending condemnation proceedings." (R. 57 par. 7)

The final decree did just that and nothing more. It awarded the property owners, including petitioner "the just compensation which the respective owners are entitled to receive from the City of New York." (R. 57, 58)

Only one sum was awarded and paid to the petitioners. The award was for "just compensation." There was no payment to the petitioner for the use of his money. No final determination of the amount due him was made until the final decree on March 31, 1937. The City took his property and the final decree fixed the "just compensation" for it, and not for the use of his money.

Thus it will be seen that petitioner asserted a claim in the condemnation proceedings for compensation for the property, and was awarded and paid the "just compensation which the respective owners were entitled to receive from the City of New York." The component elements used by the court to determine the just compensation cannot change the character of the total compensation paid to petitioner for the property. Taxation is a practical

matter, and "If the mere designation of a part of the sales price of an instrument as interest was sufficient to identify such part as interest, there might be some merit in the argument advanced, but terminology alone cannot make out of the sales price of an article something that it is not." *Anderson & Co.* v. *Commissioner*, 6 B. T. A. 713, 716. Form and terminology must be subordinated to substance. *Helvering* v. *Le Gierse*, 312 U. S. 531, 85 L. Ed. 996.

II.

The Petitioners Completed a Single Transaction in the Taxable Year on Which a Single Capital Gain Was Realized.

The decision of the circuit court of appeals segregated the just compensation the petitioners received from the City of New York for their property in a single transaction into two types of income and included the gain on that single transaction in income partly as ordinary interest income under Sec. 22(a) and the balance as capital gain limited to the percentage includible in gross income under Sec. 117 (a).

The case arises out of a single taxable event—A compulsory sale of property, as a result of which the petitioners' property was taken by the City of New York. Gains on the condemnation of property are capital gains.[2] The just compensation was determined under the New York statutes.[3] The price fixed as just compensation for property may be affected by many elements such as present

[2] The circuit court of appeals correctly held that gain on condemnation of property is taxable as capital gain. This has been the administrative rule since the Revenue Act of 1921, the first to tax capital gain on a basis different than ordinary income. I. T. 1372 (11-1 C. B. 26) The respondent does not raise the question in this court. It was raised by the taxpayer in Hawaiian Gas Products Company v. Commissioner (No. 231), certiorari denied by this Court October 12, 1942.

[3] Sec. 970 and Sec. 976 of the Greater New York Charter are printed in the Appendix, pp. 29-31.

worth of future rents, cost of reconstruction, desirability of location, need of purchaser for the property, value of money, marketability, terms of payment and even sentiment of either purchaser or seller.[4] Because the payment is not contemporaneous with the taking the New York statute, in accord with the requirements of the Fifth Amendment and the New York State Constitution, requires that so-called "interest" be awarded not as a penalty but as an incident to the ownership of the property "as part of the compensation to which such owners are entitled." (Sec. 976, *infra* p. 30.)

"Gains • • • from sales or other dealings in property • • •" are included in gross income under Sec. 22(a) of the Revenue Act of 1936, but by Sec. 117(a) the gain or loss on the sale or exchange of property constituting a capital asset is limited to percentages dependent upon the period the taxpayer held the asset. The property here involved was a capital asset and Sec. 117 has been applied to a part of the gain.

The principle underlying the special taxation of capital gains is that capital gain, unlike most other income, accrues over a period of years, and it is, therefore, inequitable to tax such gain at progressive rates in the particular year of realization. This principle is violated by the separation

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[4] In speaking of factors to be taken into consideration in fixing just compensation, this court said in Brooks-Scanlon Corp. v. United States, 265 U. S. 106,

> "The value of such ships at the time of requisition, and the then probable value at the time fixed for delivery, the contract price, the payments made and to be made, the time to elapse before completion and delivery, the possibility that by reason of the Government's action in control of materials, etc., the contractor might not be able to complete the ship at the date fixed for performance, the loss of use of money to be sustained, the amount of other expenditures to be made between the time of requisition and delivery, together with other pertinent facts, are to be taken into account and given proper weight to determine the amount claimant lost by the taking, that is, the sum which will put it in as good a position pecuniarily as it would have been in if its property had not been taken."

of the gain on a single sale of a capital asset and the inclusion of part of the gain in income as ordinary income.

If there were any doubt as to the intent or meaning of Sec. 117, it should be construed favorably to the taxpayer. *McFeely* v. *Commissioner*, 296 U. S. 101, 80 L. Ed. 84.

III.

The So-Called "Interest Included in the Award is an Integral Part of the Just Compensation. It is Not a Separate Item of Taxable Interest.

The so-called "interest" is a capital payment.

Art. 1-Sec. 7 of the Constitution of the State of New York in the same language as the Fifth Amendment to the Federal Constitution, provides that "private property shall not be taken for public use without just compensation." (R. 29) This means that the owner must be made whole. It means that the compensation to which the owner is entitled is the "full and perfect equivalent of the property taken." *Monongahela Nav. Co.* v. *United States*, 148 U. S. 312, 327; *Seaboard Air Line Railway Co.* v. *United States*, 261 U. S. 299, 67 L. Ed. 664.

The New York condemnation statute, in common with other statutes similarly worded, is calculated to work great hardship, and domain exercised under it has frequently bankrupted property owners. The property is taken without any contemporaneous compensation. Owners using their property for a home or for business, or even for lease are deprived of all and receive nothing. Then follows litigation, which is of a character likely to be protracted—in this case from 1930 to 1937. Title must be elaborately proved, and experts testify at length to high and low values. Eventually, the court determines the tentative value as best it may. That, however, is the value determined at a date long passed the date of taking the title, when the owner is deprived of his property. Quite obviously that, at a later date, is not "just compensation." A revaluation as of the later date is impossible because that would involve new liti-

gation for a new determination and so on *ad infinitum*. Hence, it becomes necessary, in order to arrive at a practical way to estimate just compensation at the date of payment to take the value of the property at the time of taking as determined by the court, and then to award "interest", not, in any sense, as an accrual upon the value at the time of taking, but as an integral part of the just compensation for the property guaranteed by the Constitution as of the time when, after delays of litigation, the City is finally called upon to pay.

People ex rel. Central Trust Co. v. Stillings, 136 App. Div. 438, 441—affirmed 198 N. Y. 504.
Matter of Minzesheimer, 144 App. Div. 576-579, affirmed an opinion below. 204 N. Y. 370.
Matter of City of New York, 222 N. Y. 370.
Matter of Starr, 198 App. Div. 859, 865, affirmed, 236 N. Y. 592.

In the *Matter of Starr*, the court said that the owner

> "is entitled to interest in question, not as a penalty or as a statutory award, but as part of the lawful and necessary full compensation for the property taken."

The amount called "interest" so-called only because interest is the yardstick by which additional compensation is measured, is part of the corpus of the award of just compensation.[5] It should not be taxed as ordinary income merely because interest factors are used to compute the ad-

[5] Cf. "Federal Eminent Domain" a Manual prepared in Lands Division of the Department of Justice, under the direction of the Attorneys General Homer Cummings, Frank Murphy and Robert H. Jackson, pp. 853-854.

"Sec. 120 A • • • Statutory provisions which prohibit interest against the United States are held inapplicable on the theory that interest is charged, not as interest, but as the amount necessary to produce a full equivalent to the value of the land paid contemporaneously with the taking. • • •

"The right to interest, as affecting the measure of 'just compensation' guaranteed by the Fifth Amendment, involves a constitutional right and therefore is substantive and not procedural."

ditional capital payment received by the owner upon the involuntary conversion of his property. It should only be taxed when there is a gain on the entire transaction.

IV.

The So-Called "Interest" is Not Interest Within the Meaning of Section 22 (a) of the Revenue Act of 1936.

This Court has considered the meaning of the term "interest" under the provisions of the revenue acts relating to deductions. It has refused to include within the scope of the deduction any item not a payment for the use of borrowed money holding that "the usual import of the term 'interest' within the revenue act is the amount which one has contracted to pay for the use of borrowed money." *Old Colony Railway Co.* v. *Commissioner*, 284 U. S. 552, 76 L. Ed. 484 (1937) and *Deputy* v. *duPont*, 308 U. S. 488, 84 L. Ed. 416 (1939).

In *Old Colony Railway Co.* v. *Commissioner, supra*, an allocable portion of premiums on bonds was not considered interest under Sec. 213 of the Revenue Act of 1921.

In *Deputy* v. *duPont, supra*, the taxpayer was obligated to return stock in kind within ten years and in the interim to pay to the lender of this stock all dividends declared and paid on the shares. The taxpayer sought to deduct an amount of $567,648 being an amount equivalent to the dividends received and $80,063.56 the taxes on the lender by reason of the payment, on the ground, among others, that it was a payment of "interest." This Court denied this claim stating:

> "There remains respondent's contention that these payments are deductible under § 23 (b) as 'interest paid or accrued . . . on indebtedness'. Clearly respondent owed an obligation to the Delaware Company. But although an indebtedness is an obligation, an obligation is not necessarily an 'indebtedness' within the meaning of § 23 (b). Nor are all carrying charges 'interest'. • • •

> "It is not enough, as urged by respondent, that 'interest' or 'indebtedness' in their original classical context may have permitted this broader meaning. We are dealing with the context of a revenue act and words which have today a well-known meaning. In the business world 'interest on indebtedness' means compensation for the use or forbearance of money. In absence of clear evidence to the contrary, we assume that Congress has used these words in that sense."

The dissenting opinion of Justice Roberts, in which Justice McReynolds joined, agreed that the payment was not "technically interest".

In the present case, the mere designation of part of the award as "interest" does not classify it as interest under Sec. 22 (a) of the Revenue Act of 1936. It is received as part payment for the property and does not come within the usual import of the term "interest".

V.

The Rule that a Deduction is Not Allowable Where the Interest or Other Deductible Expenses Are Made a Part of the Purchase Price of the Property Should Govern by Analogy.

The converse of the situation involved here has often been before the courts in tax cases. A taxpayer may purchase property on the installment basis or possession may be delivered with payment deferred to a later date. The courts have refused to allow the purchaser to segregate the portion of the price computed by the use of an interest factor even though the amount paid is denominated "interest", if in fact it was a means of adjusting the purchase price of the property:

Hundahl v. *Commissioner*, 118 F. (2d) 349 (C. C. A. 5th).

Henrietta Mills v. *Commissioner*, 52 F. (2d) 931 (C. C. A. 4th).

Pratt-Mallory Co. v. *United States*, 12 F. Supp. 1020 (Ct. Cl. 1936).

Daniel Brothers Co. v. *Commissioner*, 28 F. (2d) 761 (C. C. A. 5th).
Anderson & Co. v. *Commissioner*, 6 B. T. A. 713.

The principle of these authorities is the long established administrative rule. In I. T. 3254 (1939—1 C. B. p. 98) the Commissioner relying upon that rule held that finance charges paid in connection with the purchase of property, although denominated interest, are not deductible as interest where such amounts are part of the purchase price of the property.

This is a sound administrative rule applicable to both sellers and purchasers.

This Court has applied this rule to a related problem, namely, adjustment for taxes on property at the date of purchase. *Magruder* v. *Supplee*, (316 U. S. 394), 86 L. Ed. Ad. Op. 1025, decided May 25, 1942.

Taxpayer purchased real estate in Baltimore. State and City taxes for current year had not been paid at the date of purchase. The purchase contract provided for the apportionment of the taxes, the purchaser being allowed a credit for the taxes accrued to the date of settlement. Purchaser later paid the taxes and claimed the portion of the taxes allocable to the period after date of settlement. The Commissioner held that the local taxes were merely part of the cost of the property and were therefore capital. This Court sustained the Commissioner in his refusal to allow a deduction for taxes, holding that the payment of the taxes by the purchaser is nothing but a part of the payment for an unencumbered title.

The principle of the Supplee decision is that it is not permissible for tax purposes to segregate the purchase or sales price of property into component elements of the price. All amounts paid or received for property are capital payments. The "interest" included as an integral part of the condemnation award is a part of the price paid by the City for the property.

In *Helvering* v. *Winmill*, 305 U. S. 79, 83 L. Ed. 52, this Court had before it a case in which the taxpayer was en-

gaged in the business of buying and selling securities. He deducted from his income brokerage commissions paid and incurred in purchasing securities and claimed the deduction thereof as "an ordinary and necessary expense paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered."

This Court held that "the broker's purchase commission here constituted *a part of the acquisition cost of the securities involved*, and are not allowable to the taxpayer as a deduction from gross income under Sec. 23 (a) of the Revenue Act of 1932."

This is another example of the refusal of this Court to separate elements of cost or prices. Thus, it looks to realities and limits the gain or the loss to one thing, the "gain or loss on the sale or exchange."

The problem has also arisen in cases in which assessments are made against other property of taxpayers in condemnation proceedings. The authorities refuse to separate the award into component elements. The net award, *i. e.*, the total judgment less the amount deducted for assessments against uncondemned portions of the property is considered the net selling price, and gain is computed by deducting from that figure the basis of the property to the taxpayer. *Christian Ganahl Co.* v. *Commissioner*, 91 F. (2d) 343 (C. C. A. 9, 1937), certiorari denied, 302 U. S. 748.

After the denial of the petition for certiorari in the *Christian Ganahl* case, the respondent promulgated G. C. M. 20322 (C. B. 1938-2, p. 167) in which he adopted the principle of that case as the correct rule, holding:

> "After careful consideration, this office is of the opinion that the various steps incident to a street opening or similar improvement project, including the condemnation award for property taken, the award for severance damages to and a special benefit assessment levied against the remaining portion of the plot or parcel of real estate constitute a single proceeding the

result of which are to be calculated as an entirety for Federal income tax purposes."

This ruling was applied to the assessment made against the uncondemned portion of the petitioner's property. (Computation R. 22) It is in agreement with the following decisions of the Second and Ninth Circuit.

Christian Ganahl Co. v. *Commissioner, supra.*
Central & Pacific Imp. Corp. v. *Commissioner*, 92 F. (2d) 88 (C. C. A. 9).
Wolf v. *Commissioner*, 77 F. (2d) 455 (C. C. A. 9).
Carrano v. *Commissioner* 70 F. (2d) 319 (C. C. A. 2).

The facts in *Wolf* v. *Commissioner, supra*, illustrate the wisdom of treating a condemnation as a single taxable event. There the assessment against the uncondemned portion of the taxpayer's lot exceeded the amount of the award. The Ninth Circuit refused to separate the transaction into a sale of part of the lot and a benefit assessment against the retained part. It held that:

"* * * it is clear that the entire proceeding for the opening of a street is one proceeding, and the result should be treated as an entirety." (p. 102)

Any attempt to segregate the elements in an award of just compensation and to treat them separately for tax purposes will lead to administrative confusion and uncertainty.

VI.

The Decisions of the Circuit Court of Appeals for the Second Circuit With Which the Decision Below is in Conflict Are in Agreement With Precedent and Sound in Principle.

The Second Circuit had before it the identical issue in *Seaside Improvement Co.* v. *Commissioner, supra.*[6] It held

[6] This decision is reviewed and approved in an excellent article by John L. Rubsam, 39 Michigan Law Review, p. 170.

that the so-called "interest" was part of the capital gain and not a separate taxable item.

The decision of the Second Circuit is based upon sound authority and is correct in principle. The opinion on this point, by Judge Swan, states:

> "Finally, it is contended that the Board erred in holding that such part of the awards as was denominated 'interest' was taxable as ordinary income and not as capital gain. This question only concerns the individual petitioners, John W. Wainwright and Estate of Margaret Wainwright, since the corporate taxpayers are taxable at the same rate however the question be decided. Section 13(a) Revenue Act of 1928, 45 Stat. 797, 26 U. S. C. A. § 13 and note. We believe the petitioners' contention is sound. It is uniformly held that an owner is entitled not only to the value of the land condemned at the time of the taking but also to such additional sums as will indemnify for delay in payment of the award. *Such additional sums are not considered normal interest but part of the compensation awarded for the property taken.* Thus, they may be recovered against the United States as part of 'the just compensation' although by section 177 of the Judicial Code, as amended 28 U. S. C. A. § 284, interest may not be collected from the United States on unpaid accounts or claims. Seaboard Air Line Ry. v. United States, 261 U. S. 299, 43 S. Ct. 354, 67 L. Ed. 664; Phelps v. United States, 274 U. S. 341, 47 S. Ct. 611, 71 L. Ed. 1083; Shoshone Tribe v. United States, 299 U. S. 476, 57 S. Ct. 244, 81 L. Ed. 361. Such 'interest' is also considered as part of the condemnation award by the courts of New York. Matter of City of New York, 222 N. Y. 370, 373, 118 N. E. 807; Woodward-Brown Realty Co. v. City of New York, 235 N. Y. 278, 139 N. E. 267. It is accorded similar treatment by section 976 of the Greater New York Charter which provides that 'interest at the legal rate upon the sum or sums to which the owners are justly entitled * * * shall be awarded * * * as part of the compensation to which such owners are entitled.' Cases dealing with payments made to individuals by the Mixed Claims Commission afford a persuasive analogy to the rule that should be applied in the cases at bar. Drier v. Helver-

ing, 63 App. D. C. 283, 72 F. (2d) 76; Commissioner v. Speyer, C. C. A. 2, 77 F. (2d) 824; Helvering v. Drier, C. C. A. 4, 79 F. (2d) 501. In each of these cases a portion of the payments received by the taxpayer had been designated as interest, and the Commissioner contended that such 'interest' was part of the taxpayer's normal income; but this argument was rejected on the ground that no taxable income was received so long as the total of the award did not exceed the value of the property taken. It is obvious that in these cases the interest on the award was treated as part of the capital, for if it had been considered normal interest it would have been taxable as such irrespective of whether the taxpayer had already received a sum equal to the value of the property taken. In United States Trust Co. v. Anderson, C. C. A. 2, 65 F. (2d) 575, this court held that interest on a condemnation award was taxable, but whether it was normal income or capital gain was not discussed. For the reasons above stated we think that the portion of the awards denominated interest should be taxed as capital gain."

The question again came before the Second Circuit in the *Commissioner* v. *Appleby's Estate*, *supra*. The Court followed its previous holding, but stated that "* * * if the matter were *tabula rasa* not all of the Court as now constituted would reach that conclusion." This can mean only that a minority of the Court might not reach the same conclusion. If it meant anything else the Second Circuit would have reversed itself.

The United States Board of Tax Appeals again had the question before it after the decision of the Circuit Court of Appeals for the Third Circuit in this case. It was not impressed by the decision, and it continues to follow the decisions of the Second Circuit.

Brown v. *Commissioner*, 47 B. T. A. 139, decided June 16, 1942.

VII.

The Circuit Court of Appeals for the Third Circuit Failed to Follow the Settled Rule of this Court that the Compensation in Eminent Domain Cases Includes Interest Not as Interest per se, but as a Part of the Damages Awarded for the Property.

This Court in *Seaboard Airline Ry. Co. v. United States*, *supra*, held that although there was no provision in the Lever Act in respect of interest and Sec. 177 of the Judicial Code prohibited the allowance of interest on judgments against the United States, a judgment against the United States allowing interest at 6 per cent from the date of taking was proper in a proceeding to obtain just compensation.

This Court said:

> "It is obvious that the owner's right to just compensation cannot be made to depend upon state statutory provisions. The Constitution safeguards the right and § 10 of the Lever Act directs payment. The rule above referred to, that in the absence of agreement to pay or statute allowing it the United States will not be held liable for interest on unpaid accounts and claims, does not apply here. *The requirement that 'just compensation' shall be paid is comprehensive and includes all elements and no specific command to include interest is necessary when interest or its equivalent is a part of such compensation.* Where the United States condemns and takes possession of land before ascertaining or paying compensation, the owner is not limited to the value of the property at the time of the taking; he is entitled to such addition as will produce the full equivalent of that value paid contemporaneously with the taking. Interest at a proper rate is a good measure by which to ascertain the amount so to be added."

The rule of the *Seaboard Airline Ry. Co.* case has been applied by this Court in the following cases:

> *United States* v. *Klamath and Moadoc Tribes*, 304 U. S. 119, 82 L. Ed. 1219;

Shoshone Tribe v. *United States*, 299 U. S. 476, 496-498, 81 L. Ed. 360, 368-370, 57 S. Ct. 244;
Jacobs v. *United States*, 290 U. S. 13, 78 L. Ed. 142, 54 S. Ct. 26;
Russian Volunteer Fleet v. *United States*, 282 U. S. 481, 75 L. Ed. 473, 51 S. Ct. 229;
Liggett & Myers Tobacco Co. v. *United States*, 274 U. S. 215;
Phelps v. *United States*, 274 U. S. 341, 71 L. Ed. 1083, 47 S. Ct. 611;
Brooks-Scanlon Corp. v. *United States*, 265 U. S. 106.

The rule of these cases is that "interest" paid to property owners as a part of the award is not interest as such, or as is usually understood in the business world, but is a convenient and fair measure of one element of the sum to which the owner of the property is entitled to be paid for his property. It is a part of the price paid to indemnify the owner for his property which must be compared with the basis to ascertain if a gain or loss has been realized on the single transaction.

The circuit court of appeals (R. 45) in referring to these cases said:

> "The Supreme Court has said several times in cases involving appropriation of land by the United States that the item labelled interest in the award is really part of the just compensation to which the property owner is constitutionally entitled. We have no doubt concerning the authority or the correctness of the decisions cited."

However, instead of applying the principle of those authorities to ascertain the nature of "interest" included in an award of just compensation the Circuit Court of Appeals for the Third Circuit resorts for authority, to a text book on Damages (p. 47) the first edition of which was written in 1882, and the 4th edition in 1916, many years before this Court established the applicable doctrine. In so doing it fell into palpable error.

The quotation from Sutherland on Damages that the "interest" is awarded "not strictly as damages", which the circuit court of appeals stated "seems to be correct", is directly contrary to the decisions of this Court cited hereinbefore.

In the present case the so-called "interest" is a part of the award of compensation paid to the owner for the property not as a penalty for the use of borrowed money, but as a substantive right "attaching itself automatically to an award of damages." *Shoshone Tribe* v. *United States, supra.*

In the *Klamath* case the statute conferring jurisdiction on the Court of Claims provided: "That if it be determined by the Court of Claims in the said suit herein authorized that the United States Government has wrongfully appropriated any lands belonging to the said Indians, *damages* therefore shall be confined to the value of the said land at the time of said appropriation . . ."

The Court of Claims awarded interest against the United States on the value of the land to the date of judgment. The Government contended that the above-quoted jurisdictional act limited the recovery to the value of the land on the date of taking, without interest, irrespective of whether there was a taking within the meaning of the Fifth Amendment. This Court affirmed upon the principle that interest was an integral part of just compensation, stating (p. 123):

> "Nor is it quite accurate to say that interest as such is added to value at the time of the taking in order to arrive at just compensation subsequently ascertained and paid. The established rule is that the taking of property by the United States in the exertion of its power of eminent domain implies a promise to pay just compensation, i. e., value at the time of the taking plus an amount sufficient to produce the full equivalent of that value paid contemporaneously with the taking."

In *Shoshone Tribe* v. *United States, supra,* this court held under a jurisdictional act silent as to interest or any substitute therefor that:

> "The claimant's *damages* include such additional amount beyond the value of its property rights when taken by the Government as may be necessary to the award of just compensation, the increment to be measured either by interest on the value or by such other standard as may be suitable in the light of all the circumstances."

In *Phelps* v. *United States, supra,* the plaintiff was owner of a lease on Pier 7 of Bush Terminal in New York Harbor. The pier was requisitioned by the Secretary of War at the direction of the President in 1917. The United States occupied the pier to 1919. Plaintiff paid rent to the lessor and was reimbursed for that amount by the United States. A suit was filed in the Court of Claims to recover just compensation. The Court of Claims in 1926 awarded the value of the use, without an allowance for a sum which would produce the equivalent of the value of the use of the property paid contemporaneously.

This Court, following its prior decisions, reversed, stating:

> "Plaintiff's property was taken before its value was ascertained or paid. Judgment in 1926 for the value of the use of the property in 1918 and 1919, without more, is not sufficient to constitute just compensation. Section 177 does not prohibit the inclusion of the additional amount for which petitioner contends. It is not a claim for interest within the purpose or intention of that section. Acts of Congress are to be construed and applied in harmony with and not to thwart the purpose of the Constitution. The Government's obligation is to put the owners in as good position pecuniarily as if the use of their property had not been taken. They are entitled to have the full equivalent of the value of such use at the time of the taking paid contemporaneously with the taking. As such payment has not been made, petitioner is entitled to the additional amount claimed."

In *Liggett & Myers Tobacco Co.* v. *United States, supra,* the question involved was the claim for an additional sum measured by interest as a part of just compensation. This Court held:

> "The findings show that plaintiff's property was taken by eminent domain; and its just compensation includes the additional amount claimed."

Jacobs v. *United States, supra,* involved a suit against the United States to recover compensation for the occasional flooding of plaintiff's property. The judgment of the District Court found plaintiffs were entitled to the amount of damage "together with interest thereon at 6 per cent from date of taking until now as just compensation under the Fifth Amendment." On appeal the Circuit Court of Appeals for the Fifth Circuit held that interest was not recoverable. This Court reversed in an opinion by Chief Justice Hughes in which it is stated:

> "The amount recoverable was just compensation, not inadequate compensation. The concept of just compensation is comprehensive and includes all elements, 'and no specific command to include interest is necessary when interest or its equivalent is a part of such compensation.' The owner is not limited to the value of the property at the time of the taking; 'he is entitled to such addition as will produce the full equivalent of that value paid contemporaneously with the taking'. Interest at a proper rate 'is a good measure by which to ascertain the amount so to be added.'"

It is respectfully submitted that under the foregoing decisions the so-called "interest" included in the damages recoverable by the property owners is not interest as such, but is a part of the award of just compensation for the property. It, therefore, is not ordinary income under the Revenue laws.

VIII.

The Decision of the Circuit Court of Appeals is in Conflict With the Principle that So-Called "Interest" in a Condemnation Award is Not Interest on an Obligation of a State.

The lower courts have had occasion to decide whether the "interest" in a condemnation award is exempt from taxation under what is now Sec. 22(b)(4) of the Internal Revenue Code as "interest on an obligation of a state."

Among the decisions involving that issue are:

Holley v. *United States*, 124 F. (2d) 909 (C. C. A. 6, 1942);
Posselius v. *United States*, 31 F. Supp. 161 (Ct. Cl. 1940);
Williams Land Co. v. U. S., 31 F. Supp. 154 (Ct. Cl. 1940);
Baltimore & Ohio R. Co. v. *Commissioner*, 78 F. (2d) 460 (C. C. A. 4, 1935);
U. S. Trust Co. of New York v. *Anderson*, 65 F. (2d) 575 (C. C. A. 2, 1933).

The court below correctly stated (R. 46) that "those decisions are to the effect that the additional payments are not interest with the purview of the revenue acts." However, it suggests that they are not determinative because the problem involved is one of the scope of the exemption provision. It would seem that if "interest" is not interest for purposes of the exemption sections of the law, it is not interest for the gross income section of the same act. The case deals with the identical word under the same statute. To attribute to Congress an intent to treat part of the "just compensation" as interest under Sec. 22(a) and not as interest under Sec. 22(b) would be to violate the "natural presumption" that "identical words used in different parts of the same act are intended to have the same meaning." *Atlantic Cleaners & Dyers* v. *United States*, 286 U. S. 427, 76 L. Ed. 1204. It is submitted that Congress did not intend "interest" included in a con-

demnation award to be treated as interest under either section and that the group of cases above-cited is correctly decided.

IX.

The Principle of the Decision Below Will Result in the Taxation of a Gain as Ordinary Income When in Reality a Loss Was Sustained.

The question involved in this case has been before the courts in cases in which the amount received as just compensation, including so-called "interest", was less than the basis to the taxpayer:

Helvering v. *Drier*, 79 F. (2d) 501 (C. C. A. 4, 1935);
Commissioner v. *Speyer*, 77 F. (2d) 924 (C. C. A. 2, 1935) cert. denied 298 U. S. 631;
Drier v. *Helvering*, 72 F. (2d) 76 (C. C. A. D. C. 1934);
Consorzio Veneziano di Armamento e Navigazione v. *Commissioner*, 21 B. T. A. 984 (1930);
N. V. Koninklijke Hollandische Lloyd (Royal Holland Lloyd) v. *Commissioner*, 34 B. T. A. 830 (1936).

The circuit court of appeals cited the above court decisions in a footnote. (R. 47) It did not state that these cases were incorrectly decided. However, it avoided the weight to which those authorities were entitled by stating that they were cases "where considerations irrelevant here, were prevailing there." It would seem that if it is not proper to segregate the "interest" in a condemnation award in a case in which the net result of the transaction is a loss, it is not proper to do so when there is a gain, for Sec. 22(a) specifically includes as gross income the item of interest, separately and apart from gains on the sale of property, and irrespective of whether the taxpayer had already recovered his basis.

X.

The Principle Applied by the Circuit Court of Appeals for the Third Circuit in Taxing the Part of the Award Designated "Interest" as Ordinary Income and the Balance of the Award as Capital, Will Result in Difficulty of Administration and is Contrary to the Present Administrative Rule.

Under the decision below no part of the expenses of the condemnation proceedings is allowed as a reduction of the part of the award treated as ordinary income.[7]

The decision of the Court below segregated the so-called "interest" of $15,246.57 from the just compensation, and subjected it to tax as ordinary income, without any allowance for the attorney's fees and disbursements petitioners paid to obtain the just compensation, or the assessment paid for street opening. Thus, the so-called "interest" is treated as gain in its full amount, leaving the balance of the award to offset expenses.

We make this point not for the purpose of asking for an apportionment of the expenses between the alleged ordinary income and the capital gain on some arbitrary basis, but as illustration of the administrative difficulties which result from the decision.

There would be no need for allocations or apportionments if the transaction is treated as it really is—one sale—and

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[7] The following computation is a restatement of computation at R. 22:

Total just compensation, (including so-called "interest" $15,246.57) received by petitioners		$73,246.57
Basis to Petitioners		41,866.25
Gross gain on sale		$31,380.32
Less Amounts petitioners were required to pay:		
(1) Attorney's fees and disbursements	$2,479.39	
(2) Assessment for street opening	824.92	
		3,304.31
Petitioners' Net Gain		$28,076.01

the gain in its entirety taxed as gain on the sale of a capital asset as required by the present administrative rule, G.C.M. 20322, *supra*.

CONCLUSION.

It is respectfully submitted that the decision of the Court below is contrary to authority and unsound in principle and should be reversed.

Respectfully submitted,

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APPENDIX.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * * * * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Greater New York Charter, Chapter XVII, Title 4, Article I:

The city may acquire real property for streets, parks, et cetera.

SEC. 970. The city of New York may acquire title either in fee or to an easement, as may be determined by the board of estimate and apportionment, for the use of the public, to all or any of the real property required for streets and court-yards abutting streets, and for parks, parkways, playgrounds, approaches to bridges and tunnels and sites or lands above the water for bridges and tunnels, and sites or lands above or under water for all improvements of the navigation of waters within or separating portions of the city of New York for the improvement of the waterfronts of the city of New York, or part or parts thereof, heretofore duly laid out upon the map or plan of the city of New York, of the city of Brooklyn, or Long Island City, or of any of the territory consolidated with the corporation heretofore known as the mayor, aldermen and commonalty of the city of New York or hereafter duly laid out upon the map or plan of the city of New York, as herein constituted, and cause the same to be opened, or acquire title as above stated to such interests in real property as will promote public utility, comfort, health, enjoyment, or adornment, the acquisition of which is not elsewhere provided for. The board of estimate and apportionment may specify what use is required of the real property which it may determine shall be acquired for public use, and the extent of such use, and may direct the same to be acquired whenever and as often as it shall deem it for the public interest so to do. * * * In proceedings authorized by the board of estimate and apportionment after the first day of January, nineteen hundred and seventeen, the compensation to which the owners of real property to be acquired for the use of the public for the purposes specified in this section, shall be ascertained and determined by the supreme court without a jury in the manner and according to the procedure prescribed by this title, and on and after said date the city of New York shall make application to the court, or cause application to be made to the supreme court in a county within the city of New York

and within the judicial district in which the real property to be acquired is situated, to have the compensation, which should justly be made to the respective owners of the real property proposed to be acquired, ascertained and determined by the said court, without a jury, and to have the cost of the improvement, or such portion thereof as the board of estimate and apportionment shall direct, assessed by the court upon the real property deemed by the board of estimate and apportionment to be benefited thereby. (*As amended by L. 1922, ch. 563.*)

Vesting of title in the city to real property taken for streets or parks or other purposes.

SEC. 976. The title to the real property lying within the lines of any improvement, authorized herein, shall be vested in the city of New York upon the date of the filing of the damage map in the proceeding, provided, however, that the board of estimate and apportionment may direct, by a resolution adopted by a three-fourths vote, that the title shall be vested in the city of New York upon the date of the entry of the order granting the application to condemn or upon the filing of the final decree, as provided for in this title, or upon such other date as may be specified in said resolution, but not later than the date of the filing of the final decree. Upon the date of the entry of the order granting the application to condemn, or of the filing of the damage map in the proceeding, as the case may be, or upon such subsequent date as may be specified by resolution of said board, the city of New York shall become and be seized in fee of or of the easement, in, over, upon or under, the said real property described in the said order or damage map, as the board of estimate and apportionment may determine, the same to be held appropriated, converted, and used to and for such purpose accordingly. Interest at the legal rate upon the sum or sums to which the owners are justly entitled upon the date of the vesting of title in the city of New York, as aforesaid, from said date to date of the final decree shall be awarded by the court as part of the compensation to which such owners are entitled. The reversal on appeal of the final decree shall not divest the city of title to the real property affected by the

appeal. Upon the vesting of title the city of New York, or any person or persons acting under its authority, may immediately, or any time thereafter, take possession of the real property so vested in the city, or any part or parts thereof, without any suit or proceeding at law for that purpose.

* * * * * * * * *

The title in fee acquired by the city of New York to real property required for all purposes provided for in this title, except street and courtyard purposes, shall be a fee simple absolute. (*As amended by L. 1932, ch. 391.*)